Energy Retailers Association of Australia
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13 February 2015

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Email: NSWACTelectricity@aer.gov.au

Dear Mr Anderson,

RE: NSW electricity distribution draft determinations 2014-2015 to 2018-19

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comments in response to the Australian Energy Regulator's (AER) consultation on the NSW electricity distribution regulatory draft determinations for 2014-2015 to 2018-2019 (the **Draft Determinations**).

The ERAA represents the organisations providing electricity and gas to over 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas.

The ERAA supports the AER's draft determination as it puts in place appropriate incentive structures for the NSW distribution businesses (the distributors) to improve their capital allocation and drive operational efficiencies. We agree with the AER that the distributor's proposed operational (opex) costs are above the efficient level and even the revised proposals are still above the historic trend.[1]

We are also concerned that the presentation of information by the distributors lacks consistency and therefore makes an accurate assessment of their proposals challenging. The AER and its consultants have also identified systemic failings undermining the prudency of the proposed capital expenditure (capex), most notably through the lack of robust information and analysis.

It is the responsibility of the distributors to demonstrate that their revised proposals are underpinned by prudent systems, consistent with good operating practice, and that these systems are using robust and reliable data is critical. Where evidence is not made available, the ERAA considers that the AER's alternative program better reflects the capex criteria set out in the National Electricity Rules.

Metering exit fees

The ERAA supports the AER's approach to managing exit fees associated with metering. This is consistent with the objective of increasing competition in metering and related services as envisaged by the Australian Energy Market Commission's current work in this area. A key aspect to the AER's approach is to classify residual metering costs as a standard control service and to recover these costs through network tariffs. Under this approach, the annual charge for existing customers will include the residual capital cost. The

[1] AER, Draft decision, Ausgrid distribution determination 2015-16 to 2018-19 Overview, p. 54; AER Overview, Endeavour, p.53; AER Overview, Essential, pp, 52-53.

metering charge for a new customer, on the other hand, will not include a capital cost as they will have made an upfront capital contribution for the installation of an alternative meter. In this instance, the capital cost of the meter will be transferred into the regulated asset base and be recovered through network charges. As a result, the customer will not be exposed to a metering exit fee.

When assessing the level of annual metering charges for the distributors, the ERAA encourages the AER to set these charges at a level that is not only within an efficient range but also promotes entry into the market for meter provision. Promoting efficient market entry will allow customers to obtain advanced metering infrastructure from a range of competitive providers and therefore benefit from products and services that they could not otherwise access. Setting annual costs at a level below a new entrant's cost of service provision provides little incentive for new parties to enter the market. Effective competition, and, therefore, the diversity of customer choice, will suffer.

The removal of exit fees and clearly defined and efficiently set metering charges are both necessary to promote effective competition in metering and related services and to allow customers to compare the costs and benefits of different metering service options.

Operating expenditure

The ERAA considers that the AER has provided a convincing case for a downward adjustment to each of the distributors' base year opex. While the formation of Networks NSW has generated some improvements and efficiencies, these do not fully offset the underlying operational inefficiencies.

Benchmark modelling undertaken by the AER's consultant Economic Insights revealed that, in an environment where productivity across the sector is declining, the distributors were the least productive in the NEM.[2] In adjusting the base opex, the ERAA agrees with the AER that a holistic approach is necessary; one that balances the evidence from multiple lines of analysis. In this regard, the ERAA supports the AER's decision to recognise general limitations of the benchmarking model with respect to data imperfections and other uncertainties. These adjustments result in a balanced decision that reflects both the degree of existing inefficiencies in the distributor's business operations while at the same time providing an allowance that a prudent operator would require to achieve the operating expenditure objectives. We strongly oppose the view that consumers should bear the transition costs for the distributors to reach an efficient level.

Capital expenditure

The ERAA supports the application of a top-down approach to capex management to demonstrate that a level of discipline and restraint is imposed on the distributors. Using only a bottom-up assessment has a tendency to overstate required allowances as they do not adequately account for inter-relationships and synergies between projects or areas of work which are more readily identified at a portfolio level.

Over the last regulatory period, the distributors incurred levels of capex well above the historical trend. This was largely driven by higher than expected demand and prescriptive security standards, neither of which remains for this regulatory period. This high expenditure has delivered significant spare capacity in the networks as a result of investments to meet expected demand that did not eventuate. The ERAA considers that the improvements in network utilisation, coupled with downgraded demand and security of supply requirements, should drive an observable reduction in the amount of required capex over the 2014-19 regulatory period.

The ERAA's strong view is that the distributors must clearly demonstrate that any revised proposal is underpinned by prudent systems consistent with good operating practice and

[2] AER, *Electricity distribution network service providers Annual benchmarking report*, November 2014, p. 6

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that these systems are using robust and reliable data. Where this is not made available, the ERAA considers that based on the information presented, that the AER's alternative program better reflects the capex criteria set out in the National Electricity Rules. In that context, the magnitude of the differences between the alternative program and the initial proposals need to be considered in the context of the changed operating environments of the distributors as well as the robustness of their planning capabilities.

Weighted average cost of capital

Due to the low risks that exist in the current regulatory framework and the ability of the businesses to effectively pass on borrowing costs to consumers via retailers, the ERAA supports the AER's approach to determine systematic risk based on empirical studies of Australian energy network firms. We also agree that international comparators are not optimal as primary determinants of risk to the extent that the risks faced by these firms are not directly comparable to Australian conditions.

Should you wish to discuss the details of this submission, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,

Cameron O'Reilly
Chief Executive Officer
Energy Retailers Association of Australia

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